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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 684

THE SUPERIOR OIL COMPANY, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI

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Now comes THE SUPERIOR OIL COMPANY (Petitioner), and petitions for rehearing of Order of this Court entered May 4, 1964, dismissing its Petition For Writ of Certiorari to review judgment of the United States Court of Appeals For The Ninth Circuit reported in 322 F.2d 601. In support hereof Petitioner shows as follows:

I.

This Court's Order of May 4, 1964, undoubtedly results from the Court's view that its decision and judgment rendered April 20, 1964, in Cause No. 386 of the current term, *Federal Power Commission v. Texaco, Inc., et al.*,

as related to Pan American was dispositive of the instant Petition For Writ of Certiorari. Such is not the case. The instant Petition raised two fundamental questions, i.e.:

(1) The inherent rule-making authority of the Commission.[1]

(2) Whether Order No. 242, if within the general rule-making power of the Commission, is a reasonable, and therefore valid, exercise of such rule-making power.[2]

The Court's decision in No. 386 dealt only with the first point and that based on amendment of the Commission's Rules of Practice and Procedure adopted subsequent to Commission action herein. No. 386 in no wise dealt with the second issue above and this is apparent from the Petition For Writ therein, the Briefs in support thereof, the oral argument presented to the Court, and the decision.[3]

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[1] Questions Presented I-IV, and see Part II hereof.

[2] Questions Presented V(b) and (c):
"May the Federal Power Commission under the Natural Gas Act and its authority to make rules necessary or appropriate to carry out the provisions of that Act validily promulgate a general rule which *** (b) does not reasonably accomplish the stated purpose of the rule and (c) is unreasonable, arbitrary, capricious and discriminatory in application." (Petition for Writ Pg. 4.)

[3] **Petition** (The Questions Presented)—"Whether the Commission may proceed by way of the rule making power to prohibit contractual arrangements *** which it finds incompatible with the public interest ***." (Petition No. 386, Pg. 2.)

Brief—"Without reaching the question of the reasonableness of the Commission's indefinite-pricing regulations the decision below, held them invalid on the ground that the subject is one the Commission cannot deal with by general rule but must decide case by case. While we shall, therefore, not discuss their

Only the inherent rule-making power of the Commission was involved. That the nature of the second issue raised by this Petition is separate and distinct from that of inherent rule-making power of the Commission is fully recognized in "Memorandum For The Federal Power Commission" filed by the Solicitor General herein. Rephrasing Petitioner's above statement of said second issue, said "Memorandum" posed the same issue under "Questions Presented" as follows:

> "2. Whether the Commission's regulations, which limit the types of price changing provisions that may be included in producer contracts, are reasonable insofar as they proscribe favored nation and unlimited-price-redetermination clauses of the kind included in Petitioner's rejected filings." (Memorandum Pg. 2.)

The potential unreasonableness of Order No. 242 in its application was directly pointed to in the Petition For Writ:

> "The Commission action was arbitrary and unreasonable. The Commission requires long term (20 years plus) contracts to assure the gas supply to the purchaser

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reasonableness, we think it will be helpful to set the regulations against the background of the problems which led to their promulgation." (Solicitor General's Brief, No. 386, Pg. 15.)

Oral Argument—"The Court below set aside the Commission's regulations on the ground the regulations were invalid. Not because they were unreasonable. The Court didn't reach that question." Solicitor Wahrenbrock, Ward & Paul Tr. Pg. 4, Oral Argument: "I refer to it (Pure Oil opinion) not to argue the reasonableness of the regulations because that question was not passed on by the Court below and we have not attempted to argue it in our briefs here ***." (ID. Pg. 6.)

Decision—"We think *** that the statutory requirement for a hearing under Section 7 does not preclude the Commission from particularizing statutory standards through the rule making process ***." (Slip Opn. Pg. 6.)

> pipelines. * * * and now predict, at the producers' (not the Commission's) risk, what such conditions and the needs of the producers will be for 20 years. It is said that favored nation filings bear no apparent relationship to the economic requirements of the producers who file them. This ignores the internal competitive nature of the oil industry." (Petition Pg. 17.)

The importance of this issue to the Commission, to the companies regulated, and to the public was recognized in the Solicitor's said "Memorandum", i.e.:

> "Nor do we oppose consideration of the further question decided below, *but not reached in Texaco*, i.e. whether the rules, as applied, were a reasonable exercise of the Commission's authority. To be sure, as to this issue there is no conflict at the present time. *But the reasonableness of the rules presents a question related to the scope of the Commission's rule-making power* * * *. The regulations in question are nationwide in their application and constitute an important element in the Commission's effort to achieve effective regulation of the producers. Finally, we point out that the same issue is involved in litigation in the Fifth and Tenth Circuits. and that a definitive ruling by this Court would relieve uncertainty and contribute to the sound administration of the Natural Gas Act." (Memorandum Pg. 6. Emphasis added.)

Highlighting this point and bringing into sharp focus the reasonableness of Order No. 242, in its present application, is a decision by the Fifth Circuit Court rendered March 26, 1964, not yet officially reported, No. 20642, *Zara Foster, et al. v. The Atlantic Refining Company*,[4]

[4] Printed in full insofar as said decision relates to this point. Appendix Pages i to ix post.

which holds that a gas producer who fails to include flexible pricing clauses of the type proscribed by Order No. 242 does so at his peril. This was a suit by royalty owners for an accounting for royalty due from the sale of gas. The oil and gas lease, held by Atlantic, provided that royalties payable on gas were:

> "1/8 of that produced and saved from said land, * * * to be sold at the market price therefor prevailing for the field where produced when run * * *."

Atlantic, in 1950, entered into a 20-year contract for the sale of gas to be produced from the lease. The gas price provided was 7.018¢ per MCF for the first five-year period, increasing to 8.5¢ and then to 9.4¢ per MCF during successive five-year periods. At the time of contracting, the initial price provided was *higher* than the market price; however, by 1957 the prevailing market price established by other sales had increased to 13¢ per MCF, and for the period 1958 to 1962 the prevailing market price was 14¢ per MCF. Atlantic paid gas royalties on the contract prices. The royalty owners sued and recovered the difference of $75,000 between the contract prices and the higher market prices. Atlantic contended it should not be held responsible for the higher market price because it was impossible for it to provide in its long term contract for day-to-day or even year-to-year market price changes, and its initial contract price exceeded market price at the time of contracting. To this the Court replied:

> "The practicalities of the gas industry require that gas be sold under long-term contracts because the

[1] An interstate gas sale subject to Commission jurisdiction.

pipelines must have a committed source of supply sufficient to justify financing, construction, and operation. The impact of this economic fact on the royalty clause of the Foster-Atlantic lease produces the problem presented here." (App. Pg. III and IV)

* * *

"The impossibility argument is reduced to the question of the possibility of the inclusion in the 1950 contract of escalation provisions which would have assured the lessees the prevailing prices during the periods in question in this suit. * * *" (App. Pg. V)

"* * * The obligation of Atlantic to pay royalties is fixed and unambiguous. It made the gas sales contract with full knowledge of this obligation and did nothing to protect itself against increase in price. The fact that its purchaser would not agree to pay the market price prevailing at the time of delivery does not destroy the lease obligation." (App. Pg. V)

* * *

"Stripped of all the trimmings Atlantic's position is simply: We cannot comply. This is no answer. The lease calls for royalty based on the market price prevailing for the field where produced when run. The fact that the ascertainment of future market price may be troublesome or that the royalty provisions are improvident and result in a financial loss to Atlantic 'is not a web of the Court's weaving.' Atlantic cannot expect the court to re-write the lease to Atlantic's satisfaction." (App. Pg. VII)

The *Foster* case involves a commonplace provision for royalty on gas in oil and gas leases.[6] The *only* method by

[6] Petitioner's lease here involved covers Navajo Indian Lands subject to supervision by the Secretary of Interior. The royalty obligation is based on "value" of the gas. Value is fixed in the

which Atlantic could have protected itself would have been the inclusion in said 20-year contract of the *very type* of flexible pricing provisions proscribed by Commission Order No. 242. *Foster* judicially recognizes that such flexible pricing clauses are absolutely necessary for producer protection in long term gas sales. Such clauses bear both apparent and real relationship to the economic requirements of the producers. Without same a producer's contract is deemed "improvident" and a "web" resulting in financial loss from which a court will grant no relief. Yet these clauses are proscribed by Order No. 242 here under consideration, based on administrative determination, without an evidentiary hearing, that they bear no apparent relation to the economic requirements of producers. This determination is unfounded and is judicially repudiated in the *Foster* case.

II.

In addition to the above, to the extent that the decision in No. 386 relied on the "waiver" provision in the Commissions' Rules of Practice and procedure, Section 1.7(b), to satisfy the statutory requirement for hearing under Section 7 of the Act (No. 386, Slip Opn. Pgs. 6 and 7, FN 11), such decision is not controlling of the instant Petition. The Commission rule quoted in Footnote 11 is an amendment of said regulations which was not in

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Secretary's discretion "*** calculated on the basis of, the highest price paid or offered *** at the time of production for the major portion of *** gas *** sold from the field." The actual amount received by the lessee may be deemed "mere evidence of or conclusive evidence of such value".

Substantially similar royalty provisions are included in all leases from the United States. 43 CFR 192.82 (5)(d). 43 CFR 200.81. 43 CFR 201.41.

effect at the time of the Commission's rejection of the Petitioner's instant application nor when rehearing on said rejection was sought. The Court below so recognized (App. Pg. 6a, instant Petition For Writ). The Commission Regulation, in effect at times relevant to the instant matter, provided only for petition for *issuance, amendment or repeal* of Commission orders or rules, not *waiver*.[7]

The Court below held that "amendment or repeal" permitted by the old rule implicitly included "waiver" and equated Section 1.7(a) of the Commission's Rules to Rules 1.361(c) and 1.702 of the Rules of the Federal Communications Commission which *explicitly* provided for petitions for waiver, and otherwise read much as the Federal Power Commission's now, but not then, *amended* Rule 1.7(b) quoted in No. 386. Clearly 1.7(a) provides only a general right of petition to the Commission, and prescribes formal requirements therefor. The "implicit" meaning of the old rules *after* the amendment was obviously

[7] "1.7 PETITIONS

(a) **General.** Petitions for relief under any statute or other authority delegated to the Commission shall be in writing and under oath, shall state clearly and concisely the petitioner's grounds of interest in the subject matter, the facts relied upon, and the relief sought, and shall cite by appropriate reference the statutory provision or other authority relied upon for relief and shall conform to the requirements of Secs. 1.15 and 1.16.

(b) **For issuance, amendment or repeal of rules.** A petition for the issuance, amendment, or repeal of a rule by the Commission shall set forth clearly and concisely Petitioner's interest in the subject matter, the specific rule, amendment, or repeal requested, and cite by appropriate reference the statutory provision or other authority therefor. Such petition shall set forth the purpose of, and the facts claimed to constitute the grounds requiring, such rule, amendment or repeal, and shall conform to the requirements of Secs. 1.15 and 1.16. Petitions for the issuance or amendment of a rule shall incorporate the proposed rule or amendment."

not implicit before; otherwise the need, which the Commission recognized, for amendment to explicitly permit petitions for *waiver* would not have existed. If any prior *implicit* right to seek waiver may be found, it is submitted that such tenuous and uncertain right to a hearing is no substitute for the clear and express hearing right, and due process of law, unqualifiedly granted by Section 7 of the Natural Gas Act.

PRAYER

WHEREFORE, PETITIONER PRAYS for rehearing of its Petition For Writ of Certiorari, and that upon such rehearing said writ be granted.

Respectfully submitted.

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May 14, 1964.

This is to certify that this Petition For Rehearing is presented in good faith and not for delay, and is restricted to intervening circumstances and other substantial grounds not previously presented.

H. W. VARNER
Attorney for Petitioner

May 14, 1964.

APPENDIX

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 20642

ZARA FOSTER, ET AL.,
Appellants-Appellees,

versus

THE ATLANTIC REFINING COMPANY,
Appellee-Appellant.

(AND REVERSE TITLE)

Appeals from the United States District Court for the Southern District of Texas

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(March 26, 1964.)

Before HUTCHESON, BREITENSTEIN,* and BELL, Circuit Judges.

BREITENSTEIN, Circuit Judge: We have here a complex controversy between lessors and lessee over their respective rights under a Texas oil and gas lease. The issues concern the failure to account for royalties due, to pay com-

*Of the Tenth Circuit, sitting by designation.

pensatory royalties, to produce and market, and to develop. The factual issues were presented to a jury which answered numerous special interrogatories. The trial court gave judgment in favor of the lessors and against the lessee in the sum of $154,931.29. Both sides have appealed.

In 1944 the Fosters, appellees and cross-appellants herein referred to as lessors or as Fosters, gave an oil and gas lease to The Atlantic Refining Company, appellant and cross-appellee herein referred to as lessee or as Atlantic. The lease covered 1,500 acres located in the Hagist Ranch Field, Duval County, Texas. The Hagist Ranch Field is a multi-reservoir field which produces both oil and gas. We shall discuss each appeal and issue separately.

I.

ATLANTIC APPEAL

(a) Failure to account for royalties.

The lessors contend that the lessee has not paid gas royalties to which they are entitled. The royalty clause reads in pertinent part:

> "The conventional royalties to be paid by Lessee are: (a) On oil and gas, including all hydro-carbons, one-eighth (1/8th) of that produced and saved from said land, the same to be delivered to the credit of the Lessor into the pipe line and to be sold at the market price therefor prevailing for the field where produced when run; * * *."

In 1950, lessee made a 20-year gas sales contract with Texas Illinois Natural Gas Pipeline Company covering the

Foster and other leases owned by Atlantic in the Hagist Ranch Field. The prices to be paid by the pipeline company per mcf were:

> "7.0180 cents during the first five year period; 8.5531 cents during the next five year period; and 9.4304 cents during the third five year period.
>
> "For the fourth five year period the price shall be the fair and reasonable value thereof as of the commencement of said period, taking into consideration the price then being paid for gas of similar quantity and quality sold for similar purposes in the general area of the Hagist Ranch Area, provided, however, that in no event shall such price be less than 10.0883 cents for each 1,000 cubic feet of gas."

The uncontroverted evidence is that the price prevailing for the field was 13 cents in 1957 and 14 cents for the period 1958-1962.[1] The Fosters claim that they are entitled to royalties based on these prices rather than on the prices fixed by the 1950 gas sales contract. The trial court agreed with the Fosters and, on this issue, gave them judgment for $75,012.51, the difference between what they were paid and what the court held they should have been paid.

The practicalities of the gas industry require that gas be sold under long-term contracts because the pipelines must have a committed source of supply sufficient to justify

[1] Lessors concede that the 4-year statute of limitations applies, Vernon's Ann. Civ. St. art. 5527, and that they cannot go back beyond four years from the filing of the original complaint in 1961.

financing, construction, and operation.[2] The impact of this economic fact on the royalty clause of the Foster-Atlantic lease produces the problem presented here.

Undisputed testimony for Atlantic is that at the time it made the 1950 contract with Texas Illinois it received a higher initial price and an agreement for a substantially higher daily take of gas than could have been negotiated with the other two pipelines operating in the area.[3] The 13-cent and 14-cent prices on which the Fosters rely were established by the testimony of an expert who directed particular attention to four long-term contracts made in 1949, 1952, and 1956, and are not controverted by Atlantic.

Atlantic says that compliance with the royalty provision of the lease as interpreted by the Fosters and the trial court is impossible. It argues that no pipeline or other purchaser will buy large quantities of gas on a day to day or other short-term basis. In this the jury agreed as it answered in favor of Atlantic interrogatories presenting the questions of the salability of the gas on a day to day, month to month, or year to year basis. As we see the case these factors are immaterial. The Fosters make no claims based on short-term fluctuations in price. Instead they say that the market price of gas in 1957 was 13 cents and in the period 1958-1962 was 14 cents. Atlantic offered no evidence of day to day, month to month, or year to year fluctuations in price. This court said in *Phillips Petroleum Co. v. Bynum*, 5 Cir., 155 F.2d 196, 198, that: "* * * [W]hen seeking market value gas at the well we cannot require the application of rules of daily sales and

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[2] See Gex v. Texas Company, Tex. Civ. App., 337 S.W.2d 820, 828.

[3] Texas Illinois had not then entered into the area.

daily quotations when there is no showing that such sales and quotations occur." The record conclusively establishes that the market price of the gas prevailing in the field when the gas was delivered to the pipeline was 13 cents in 1957 and 14 cents in the 1958-1962 period.

The impossibility argument is reduced to the question of the possibility of the inclusion in the 1950 contract of escalation provisions which would have assured the lessees the prevailing prices during the periods in question in this suit. Atlantic says, and the jury found, that such provisions could not have been incorporated in a contract having the initial price and delivery quantity agreements contained in the 1950 contract. The Fosters do not dispute this but say that such impossibility is no excuse.

The inability of Atlantic to make a gas sales contract with escalation provisions is beside the point. The obligation of Atlantic to pay royalties is fixed and unambiguous. It made the gas sales contract with full knowledge of this obligation and did nothing to protect itself against increases in price. The fact that its purchaser would not agree to pay the market price prevailing at the time of delivery does not destroy the lease obligation. The case falls within the rule thus stated in *Ellwood v. Nutex Oil Co.*, Tex. Civ. App., 148 S.W.2d 862, 864:

> "* * * [O]ne who unconditionally obligates himself to do a thing possible of performance, must be held to perform it (citing cases); and though performance, subsequent to the contract, may become difficult or even impossible, [this] does not relieve the promisor, and particularly where he might have foreseen the difficulty and impossibility (citing cases)."

When it made the gas sales contract, Atlantic took the calculated risk of that contract producing royalties satisfactory to the lease terms. The fact that increases in market prices have made the lease obligations financially burdensome is no defense.

Atlantic urges that the market price is the price at which the gas was sold in 1950. Developing this point it first says that the phrase "when run" applies to oil but not to gas on the theory that a "run" is a transfer of crude oil from stock tanks to a pipeline.[4] We see no reason why the phrase may not apply to gas and mean the time of delivery of gas from the well to the pipeline. Indeed, a witness for Atlantic so testified.[5]

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[4] See Long v. Magnolia Petroleum Company, 166 Neb. 410, 89 N.W.2d 245, 257.

[5] Atlantic witness Echols testified in part thus:

"Q. But what does the contract say?

A. This contract says to be sold at the market price therefor.

Q. Prevailing in the field?

A. Yes, sir.

Q. When run?

A. That's correct.

Q. When the gas is run, is that right?

A. That's right.

Q. All right. Now that gas is run every day that those wells produce, isn't it?

A. Yes, sir, but that gas is not sold every day when the leases are producing.

* * * * * * *

"Q. All right. Now then, when it says 'gas (sic) run,' let's get to that point next.

A. Well, of course, the terminology 'run' does not actually apply to gas, but I would twist and say it probably refers to it at the time it is delivered to the pipeline.

Q. Now it actually refers to it there, doesn't it?

A. I presume it does."

Atlantic also says that the gas was sold in 1950 for future delivery. The difficulty is that under a Texas decision, *Martin v. Amis*, Tex. Com. App., 288 S.W. 431, 433, the 1950 contract was an executory contract for the sale of gas with an executed sale of gas being effected when the gas came into possession of the pipeline.

Atlantic argues that it is only required to use reasonable diligence in selling the Foster royalty gas and that the 1950 contract was not improvident. These arguments beg the question. The royalty provision is clear. Granting that the 1950 contract was provident when made, that fact does not change the royalty provisions.

Stripped of all the trimmings Atlantic's position is simply: We cannot comply. This is no answer. The lease calls for royalty based on the market price prevailing for the field where produced when run. The fact that the ascertainment of future market price may be troublesome or that the royalty provisions are improvident and result in a financial loss to Atlantic "is not a web of the Court's weaving."[6] Atlantic cannot expect the court to rewrite the lease to Atlantic's satisfaction.

This brings us to the contention of Atlantic that the lessors ratified the 1950 contract by accepting the royalties payable thereunder and are now estopped to claim royalties based on a higher market price. Atlantic relies on the principle that ratification is established where a principal, though having no prior knowledge of the unauthorized acts of

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[6] Phillips Petroleum Co. v. Bynum, 5 Cir., 155 F.2d 196, 198, certiorari denied 329 U.S. 714.

his agent, retains benefits after acquiring full knowledge of those acts.[7]

The accepted principles of agency and estoppel do not apply in the circumstances of this case. Atlantic had the right to make a sales contract for lessors' gas. This contract was valid and the lessors could do nothing about it. In that contract Atlantic warranted its title and agreed to pay royalties "in accordance with the terms of the respective leases." The facts and laws establish the right of the Fosters to a royalty based on a higher price than that provided in the 1950 contract. This court has held that the acceptance by the lessors of less royalty than that to which they were entitled does not "extinguish the entire debt nor work an estoppel."[8] By keeping less than was due them, and something to which they were entitled in any event, the Fosters have not ratified the act of Atlantic in selling their royalty gas for less than the prevailing market price.

Atlantic says that the 4-year statute of limitations bars recovery as the breach, if there was one, occurred in 1950 when the gas sales contract was executed.[9] As previously stated, the 1950 contract was not a present sale of the gas.[10] The Texas rule is that the statute begins to run on money due as royalty under a written contract when such money

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[7] See Blackburn v. Automobile Finance Co., Tex. Civ. App., 121 S.W.2d 388, 389.

[8] Arkansas Natural Gas Corporation v. Sartor, 5 Cir., 98 F.2d 527, 530, certiorari denied 305 U.S. 649.

[9] See Vernon's Ann. Civ. St., art. 5527.

[10] See Martin v. Amis, Tex. Com. App., 288 S.W. 431, 433.

is due and payable.[11] In the case before us the money did not become due and payable until after an executed sale of the gas was made by the delivery of the gas to the pipeline.

The trial court correctly held that the Fosters were entitled to royalty on the prices prevailing in the period 1957-1962.

* * * *

[11] See Hickok Producing & Development Co. v. Texas Co., 5 Cir., 128 F.2d 183, 185; Phillips Petroleum Co. v. Johnson, 5 Cir., 155 F.2d 185, 190 certiorari denied 329 U.S. 730.